

## **FAIR POLITICAL PRACTICES COMMISSION**

### **Memorandum**

**To:** Chairman Johnson and Commissioners Hodson, Huguenin, Leidigh and Remy

**From:** Valentina Joyce, Commission Counsel, Legal Division  
Luisa Menchaca, General Counsel

**Subject:** Adoption of Proposed Amendment to Recordkeeping Requirements:  
Electronically Processed Checks - Regulation 18401.

**Date:** February 13, 2007

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### **I. Executive Summary**

Candidates, treasurers and elected officers have a duty to maintain detailed accounts, records, bills, and receipts necessary to prepare campaign statements and to establish that campaign statements were properly filed. (Section 84104 of the Political Reform Act (the “Act”).)<sup>1</sup> Regulation 18401 identifies the records that must be maintained. Subsection (a)(4)(B) defines what documents must be maintained as “original source documentation” for expenditures of \$25 or more, or a series of payments for a single product or service that totals \$25 or more. It provides, in pertinent part, that original source documentation shall consist of cancelled checks made from any checking or savings account or any other campaign accounts.

Since adoption of this regulation, many banks no longer return original cancelled checks to their customers. Federal law allows banks to process checks by capturing a picture of the front and back of the check along with the associated payment information and transmit this information electronically. Paper checks no longer need to be physically moved from one bank to another to be honored. Checks processed in this manner are commonly referred to as “electronic checks.”

By referring simply to “cancelled checks” as original source documentation, regulation 18401(a)(4)(B) does not contemplate electronic processing of checks. The proposed amendment would include documentation for the processing of electronic checks within the regulation’s requirement for maintaining original source documentation.

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<sup>1</sup> Government Code sections 81000 – 91014. Commission regulations appear at title 2, sections 18109 – 18997 of the California Code of Regulations. All references to statutory “sections” are to the Government Code, and all references to “regulations” are to title 2 of the California Code of Regulations, unless otherwise indicated.

## II. Background

Section 84104 of the Act provides in pertinent part:

“It shall be the duty of each candidate, treasurer, and elected officer to maintain detailed accounts, records, bills, and receipts necessary to prepare campaign statements, to establish that campaign statements were properly filed, and to otherwise comply with the provisions of this chapter ...”

The statute is silent as to what detailed information and what backup records are “necessary” to support the information disclosed on campaign statements. Regulation 18401 specifies what original source documentation must be retained in order to ensure compliance and facilitate enforcement of the Act’s reporting requirements.

The records retention rules serve a vital purpose under the Act. Section 90001 *et seq.* provides for the auditing of certain committees either by the Franchise Tax Board or the Commission. Section 90007 requires the Commission to adopt auditing guidelines and standards “to encourage compliance and detect violations” of the Act. One such guideline, appearing in regulation 18995(b)(4), states that “[s]ufficient, competent evidence, including source documents, is to be obtained through inspection, observations, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the filing under examination.” Accordingly, auditors must examine records and documents that are more specifically described in regulation 18401.

Regulation 18401(a)(4) specifies what records and documents must be maintained for an expenditure of \$25 or more, or a series of payments for a single product or service which totals \$25 or more:

“(A) The accounts and records shall contain the date the expenditure was made (or, for an accrued expense, the date of goods or services were received), the amount of the expenditure, the full name and street address of the payee, and a description of the goods or services for which each expenditure was made. If the person or vendor providing the goods or services is different from the payee, the accounts and records shall contain the same detailed information for such person or vendor. For an expenditure which is a contribution to another candidate or committee, or is an independent expenditure, the records shall contain the cumulative amount of such contributions to, or independent expenditures to support or oppose, each candidate, committee, or ballot measure.

“(B) The original source documentation shall consist of cancelled checks, wire transfers, credit card charge slips,

bills, receipts, invoices, statements, vouchers, and any other documents reflecting obligations incurred by the candidate, elected officer, campaign treasurer, or committee, and disbursements made from any checking or savings account, or any other campaign accounts, in any bank or other financial institution.”

The primary distinction between “records” (subsection (A) above) and “original source documentation” (subsection (B) above) is that original source documents generally come from external sources. Auditors consider a cancelled check to be the best evidence of an expenditure.

### **III. Proposed Amendment**

As a result of the enactment of the Check Clearing for the 21<sup>st</sup> Century Act (12 USC 5001, commonly referred to as “Check 21”), most banks now process checks electronically and provide their customers with image statements, which contain photocopies of multiple checks on one page or copies of checks that can be downloaded from the Internet. These do not currently satisfy the regulation’s requirement for cancelled checks. In order to satisfy the need of auditors to “obtain sufficient competent evidence including source documents,” another form of original source documentation should be allowed for checks that have been processed electronically.

At the prenotice meeting, the Commission proposed amending section 18401 by adding the following language:

“In lieu of cancelled checks, the original source documentation may consist of copies of cancelled checks that contain a legible image of the front and back of the cancelled check, provided the copy was obtained from the financial institution.”

This language would permit using copies of original cancelled checks, substitute checks or checks downloaded from the Internet as long as the copies:

- are copies of “cancelled checks,” i.e., checks that have been approved for payment and have cleared the appropriate account of a financial institution;
- are “legible” to avoid relying solely on the use of image statements containing very small images of checks that may be difficult or impossible to read;
- include images of the front and back of the check; and
- are obtained from the financial institution.

The only difference between this language and that proposed by staff at the prenotice meeting is that the Commissioners agreed to delete the requirement that the copies be “true-to-size.”

#### **IV. Staff Recommendation**

Staff recommends adoption of the proposed amendment to regulation 18401.

#### **Attachment**

Proposed Amendment to Regulation 18401.